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State of Montana
Office of the Legislative Auditor

REPORT TO THE LEGISLATURE

MONTANA ARTS COUNCIL

Financial-Compliance Audit for the Two Fiscal Years Ended June 30, 1985

PLEASE RETURN

This report contains eight recommendations for improvement of the council's operations. The major items addressed in this report include:

- Contract employees that should be classified as state employees.
- Inaccurate and untimely federal reports.

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FINANCIAL-COMPLIANCE AUDITS

Financial-compliance audits are conducted by the Office of the Legislative Auditor to determine if an agency's financial operations are properly conducted, the financial reports are presented fairly, and the agency has complied with applicable laws and regulations which could have a significant impact on the financial schedules. In performing the audit work, the audit staff uses standards set forth by the American Institute of Certified Public Accountants and the United States General Accounting Office.

Financial-compliance audit staff members hold degrees with an emphasis in accounting. Most staff members hold Certified Public Accountant (CPA) certificates.

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Office of the Legislative Auditor

MONTANA ARTS COUNCIL

Financial and Compliance Audit for the
Two Fiscal Years Ended June 30, 1985

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February 1986

The Legislative Audit Committee
of the Montana State Legislature:

This is the financial-compliance audit report on the Montana Arts Council's financial activity for fiscal years 1983-84 and 1984-85. The department's written response to audit recommendations is included in the back of the audit report.

We thank the executive director and the council's staff for their cooperation and assistance throughout the audit.

Respectfully submitted,

Scott A. Seacat
Legislative Auditor

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MONTANA ARTS COUNCIL

APPOINTIVE AND ADMINISTRATIVE OFFICIALS

Montana Arts Council Members

		Term Expires
Sue Talbot (Chairperson)	Missoula	1988
James M. Colla	Great Falls	1987
Emily S. Day	Wolf Point	1990
Shirley L. Hanson	Havre	1988
Sonia Hoffman	Helena	1988
Claudette Morton	Helena	1988
Howard Obenhoff	Butte	1990
Randall Ogle	Kalispell	1987
Larry Pirnie	Missoula	1988
Janice Snow	Missoula	1990
Jessica Stickney	Miles City	1987
Charles F. Tooley	Billings	1987
Carolyn Valacich	Great Falls	1990
James Whitlock	Hamilton	1990
Patrick Zentz	Laurel	1987

Administrative Officials

David E. Nelson	Executive Director
Jo-Anne Mussulman	Grants Officer

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SUMMARY OF AUDIT RECOMMENDATIONS

This listing serves as a means of summarizing the recommendations contained in the report and the council's reply. Recommendation numbers 2, 4, and 8B were made in our previous audit and have not been implemented.

Page

Recommendation #1

The council and the Office of Budget and Program Planning convert contract employee positions to state FTE. 4

Agency Response: Concur. See page 29.

Office of Budget and Program Planning Response: Concur. See page 33.

Recommendation #2

The council:

A. Ensure federal financial reports are prepared in accordance with the instructions included in "Circular A-102, Attachment H." 7

Agency Response: Concur. See page 29.

B. Submit reports in a timely manner or obtain written documentation from the NEA approving an extension of the reporting deadline. 7

Agency Response: Concur. See page 29.

C. Establish procedures to ensure subgrantees issue required reports to the council in a timely manner. 7

Agency Response: Concur. See page 29.

Recommendation #3

The council:

A. Ensure subgrantees commit the granted funds within the grant period before disbursing the final payment. 8

Agency Response: Concur. See page 29.

SUMMARY OF RECOMMENDATIONS (Continued)

Page

B. Request reimbursement from the grantees for the above unallowable grant expenditures. 8

Agency Response: Conditionally concur. See page 30.

Recommendation #4

The council negotiate an agreement with the federal government to recover indirect costs incurred in administering federal grants. 9

Agency Response: Concur. See page 30.

Recommendation #5

The council:

A. Restrictively endorse checks immediately upon receipt. 11

Agency Response: Concur. See page 30.

B. Make deposits in accordance with state law. 11

Agency Response: Concur. See page 30.

Recommendation #6

The council:

A. Reverse accrual transactions not based on valid obligations. 14

Agency Response: Do not concur. See page 30.

B. Comply with state policy regarding expenditure recognition and accrue only when valid obligations exist. 14

Agency Response: Concur. See page 31.

SUMMARY OF RECOMMENDATIONS (Continued)

Page

Recommendation #7

The council comply with state property accounting policy by implementing the property accountability management system. 14

Agency Response: Concur. See page 31.

Recommendation #8

The council:

A. Obtain necessary SBAS training for its accounting staff. 17

Agency Response: Concur. See page 31.

B. Record federal grant revenue in accordance with state accounting policy. 17

Agency Response: Concur. See page 31.

C. Comply with state policy by following the procedures outlined in the year-end cash cutoff memo. 17

Agency Response: Concur. See page 31.

D. Comply with state policy by adequately supporting all SBAS documents. 17

Agency Response: Concur. See page 31.

INTRODUCTION

We performed a financial-compliance audit of the Montana Arts Council (council) for each of the two fiscal years ended June 30, 1984, and 1985. The objectives of the audit were to: 1) determine the department's compliance with applicable laws and regulations; 2) make recommendations for improvement in the department's management and internal controls; and 3) determine if the department's financial schedules present fairly the results of its operations for each of the two fiscal years ended June 30, 1984, and 1985.

This report contains eight recommendations to the council. These recommendations address areas where the council can improve management, financial reporting, and compliance with laws and regulations. Other areas of concern deemed not to have a significant effect on the successful operations of the council are not included in this report but have been discussed with management.

To meet federal reporting requirements the body of the audit report discusses instances of noncompliance with laws and regulations. For those transactions not tested, nothing came to our attention in connection with our examination that caused us to believe that the Montana Arts Council was not in compliance with the terms and provisions of state and federal laws and regulations.

In accordance with section 5-13-307, MCA, we analyzed the costs of implementing the recommendations made in the report. Each report section discloses the cost, if significant, of implementing the recommendation.

BACKGROUND

The Montana Arts Council was established as a state agency in 1967. The council works with the State Board of Education for purposes of planning and coordination.

The council consists of fifteen members who are appointed by the governor and, with the consent of the Senate, serve a five-year term. The council members are responsible for the

governance, management, and control of the agency. Council members do not receive any compensation for their services but do receive reimbursement of travel expenses. The council's duties are to:

1. encourage the study and presentation of the arts throughout the state;
2. stimulate public interest and participation in the arts;
3. cooperate with public and private institutions engaged in cultural and aesthetic activities;
4. foster public interest in the cultural heritage of Montana and expand the state's cultural resources; and
5. encourage and assist freedom of artistic expression.

The council has two primary sources of funding: federal grants and investment earnings from the Coal Tax Park Acquisition Trust Fund. The federal grants are received from the National Endowment of the Arts. The council contracts with individuals or grants the money to nonprofit organizations in the state for completion of various art projects. The National Endowment requires the state or subgrantee to match the federal funds on at least a dollar-for-dollar basis.

The council receives one-third of the investment earnings from the Coal Tax Park Acquisition Trust Fund for the Cultural and Aesthetic Program. The legislature determines which organizations will receive the money and the council regrants the money as specified. The council received a biennial appropriation of $794,830 for regrants and $28,649 to administer the program.

SUMMARY OF PRIOR AUDIT RECOMMENDATIONS

The audit for the Montana Arts Council for the two fiscal years ended June 30, 1983, was performed by our office. That audit report contained seven separate recommendations directed to the council. We reviewed the status of these recommendations with

the following results: three were not implemented, two were partially implemented, and two no longer apply.

The council concurred with the three prior audit recommendations which were not implemented. These recommendations and recommendations partially implemented are addressed in various sections of this report.

CONTRACT EMPLOYEES

Seven of the eleven Montana Arts Council's employees are contracted through the Montana Institute of the Arts Foundation. The council reimburses the Montana Institute of the Arts Foundation for all services performed by the contract employees. This includes regular hours, vacation and sick leave, health benefits, and retirement.

Section 39-71-120, MCA, defines an independent contractor as follows:

> An "independent contractor" is one who renders service in the course of an occupation and:
> (1) has been and will continue to be free from control or direction over the performance of the services, both under his contract and in fact; and
> (2) is engaged in an independently established trade, occupation, profession, or business.

The council has full supervisory discretion and control over the contract employees. Services provided by these employees are not outside the usual course of business for council employees and are performed at the Montana Arts Council's place of business. Contract employees provide clerical support, accounting support, and project direction for the council. In addition, the council shares a position with the Montana State Library. This employee works twenty hours a week at each agency performing the same duties at each location. At the State Library the employee is paid as a state employee while at the council the employee is considered a contract employee. Based on the above factors, it is clear the

contract employees at the council do not fit the criteria as independent contractors.

These employees are not receiving all state benefits as are other council employees who are performing the same type of work. The council reimburses the Montana Institute of the Arts Foundation for the employer's share of taxes, such as federal social security taxes, and state workers' compensation and unemployment insurance contributions. The required tax reports are filed by the Arts Foundation. If these reports were not filed by the Arts Foundation, the state would be responsible since under state law the contract employees are state employees.

As previously discussed, the council's contracted employees do not fit the criteria of an independent contractor as defined by state law. The council has requested the Office of Budget and Program Planning convert these contract employees to state employees by increasing the number of state FTE. The Office of Budget and Program Planning has supported the council's request but the request was denied during the legislative process.

RECOMMENDATION #1

WE RECOMMEND THE MONTANA ARTS COUNCIL AND THE OFFICE OF BUDGET AND PROGRAM PLANNING CONVERT CONTRACT EMPLOYEE POSITIONS TO STATE FTE.

FEDERAL COMPLIANCE

The council receives funding from the National Endowment for the Arts (NEA) in the form of two grants, the Basic State Grant (BSG) and the Artist in the Schools program (AIS) as illustrated on the schedule on page 27. Funds from the BSG are subgranted to nonprofit organizations, used to pay a portion of the council's operating costs, and used to supplement AIS grants in funding that program. Both grants require the grantee or subgrantee to match federal funds at least dollar-for-dollar.

Office of Management and Budget (OMB) "Circular A-102, Attachment P," establishes audit requirements for state and local governments receiving federal assistance. Attachment P provides for independent audits of financial operations, including compliance with certain federal laws and regulations. We performed our audit of the council in accordance with the standards of OMB "Circular A-102, Attachment P."

We reviewed major compliance areas for grants received from the National Endowment for the Arts. Areas reviewed include:

1. cost allowability;
2. financial reporting systems;
3. eligibility determination; and
4. audit requirements.

During our review we noted compliance problems in the completion of required reports. We determined the effects of this noncompliance on program accomplishments and the allowability of costs. In the following section of our audit report we discuss compliance problems requiring disclosure in accordance with Attachment P.

As a result of our review, it is our opinion that the deficiencies noted did not significantly affect the successful operation of the programs or the allowability of costs in conformity with program regulations.

Federal Reports

The Montana Arts Council did not comply with federal regulations regarding federal reports. The council does not have procedures to ensure federal reports are accurate or subgrantee final expenditure reports are received in a timely manner. Our prior audit recommended the council establish procedures to ensure federal reports are accurate and timely. The council concurred with the recommendation but did not implement it. This is discussed in more detail in the following two subsections.

Precision

The council's final BSG financial status report for fiscal year 1983-84 was not correct. The final AIS financial status reports for fiscal years 1983-84 and 1984-85 were also incorrect. In all cases, the council did not correctly calculate the nonfederal share of outlays. For example, the fiscal year 1983-84 final BSG financial status report stated the amount of nonfederal share of outlays as $1,425,213. The amount that should have been reported was $1,484,201, which resulted in a $58,988 understatement of nonfederal outlays reported.

Federal instructions for completing the Financial Status Report Form, contained in "Circular A-102, Attachment H," state that all nonfederal outlays should be reported. This information is important in order to verify nonfederal matching requirements have been met. We determined the matching requirements had been met after considering the effect of the errors on the reports.

Timeliness

The fiscal year 1983-84 BSG financial report, fiscal year 1983-84 and 1984-85 AIS financial reports, and fiscal year 1984-85 Folklife financial report were not submitted before the required deadline. For example, the 1984-85 AIS financial report deadline was September 30, 1985. The report was not submitted until December 18, 1985.

Federal instructions in "Circular A-102, Attachment H" specify that Financial Status Reports must be submitted within ninety days of the annual reporting period. The regulations allow for extensions at the request of the grantee. If deadlines cannot be met the council should obtain written approval from the NEA for extensions.

A council official stated the reason for the BSG report being untimely is because the council does not receive the subgrantees' final reports in a timely manner. Also the council believed the annual reporting period ended August 30, rather than June 30.

RECOMMENDATION #2

WE RECOMMEND THE MONTANA ARTS COUNCIL:

A. ENSURE FEDERAL FINANCIAL REPORTS ARE PREPARED IN ACCORDANCE WITH THE INSTRUCTIONS INCLUDED IN "CIRCULAR A-102, ATTACHMENT H."

B. SUBMIT REPORTS IN A TIMELY MANNER OR OBTAIN WRITTEN DOCUMENTATION FROM THE NEA APPROVING AN EXTENSION OF THE REPORTING DEADLINE.

C. ESTABLISH PROCEDURES TO ENSURE SUBGRANTEES ISSUE REQUIRED REPORTS TO THE COUNCIL IN A TIMELY MANNER.

STATE COMPLIANCE

We have examined the financial schedules of the Montana Arts Council for the years ended June 30, 1984, and June 30, 1985, and have issued our report thereon dated January 20, 1986. Our examination was made in accordance with generally accepted auditing standards and, accordingly, included such tests of the accounting records and such other auditing procedures as we considered necessary in the circumstances.

Except for the instances of noncompliance described in the following two sections, the Montana Arts Council complied with the terms and provisions of laws and regulations for the transactions tested.

The noncompliance conditions described below were considered in determining the nature, timing, and extent of the audit tests to be applied in our examination, and these conditions do not affect our opinion on the Montana Arts Council's financial schedules dated January 20, 1986.

Subgrantee Expenditures

The council receives earnings from the Coal Tax Park Acquisition Trust Fund to fund the Cultural and Aesthetic program. The legislature grants specific amounts to organizations for various art projects and the council administers the grants. State law requires

the Cultural and Aesthetic program subgrantees to commit all their funds during the grant period. The grant period consisted of the two fiscal years ending June 30, 1985. Three out of the fifteen grants tested had expenditures outside of the grant period.

In order to receive the state funds, the council requires that the subgrantee sign an agreement stipulating that "any funds granted must be committed within the grant period." The council is not requiring the subgrantee to comply with this agreement and, therefore, unallowable grant expenditures are being made. One grantee had difficulty in obtaining an acceptable bid for materials needed to finish the project. The bid was received in October 1985 which was three months past the end of the grant period. This resulted in $27,500 of the $30,000 grant being expended outside the grant period.

Another grantee used $2,700 of its grant for work completed two years before the grant period. The third exception consisted of $50 of travel expenditures made outside of the grant period.

A council official stated special circumstances arose and the funds could not be committed during the grant period.

RECOMMENDATION #3

WE RECOMMEND THE MONTANA ARTS COUNCIL:

A. ENSURE SUBGRANTEES COMMIT THE GRANTED FUNDS WITHIN THE GRANT PERIOD BEFORE DISBURSING THE FINAL PAYMENT.

B. REQUEST REIMBURSEMENT FROM THE SUBGRANTEES FOR THE ABOVE UNALLOWABLE GRANT EXPENDITURES.

Indirect Cost Recovery

The council did not comply with section 17-3-111, MCA, which requires state agencies to recover indirect costs of federal assistance programs to the fullest extent possible. In order to comply with the state law, the council should have negotiated an

agreement with the federal government to recover indirect costs incurred in administering federal grants. We recommended that an indirect cost recovery agreement be negotiated with the federal government during our prior audit. The council concurred with the recommendation but did not implement it.

The Department of Administration's Statewide Cost Allocation Plan for fiscal years 1983-84 and 1984-85 allocated $11,513 and $10,371, respectively, to the council. If the council had an agreement for indirect cost recovery with the federal government, approximately $5,306 and $3,431 for fiscal year 1983-84 and 1984-85 could have been recovered and reimbursed to the state's General Fund. Since an agreement was not negotiated, the General Fund absorbed all the indirect costs. A council official stated that the council is currently receiving guidance on how to negotiate an agreement with the federal government.

RECOMMENDATION #4

WE RECOMMEND THE MONTANA ARTS COUNCIL NEGOTIATE AN AGREEMENT WITH THE FEDERAL GOVERNMENT TO RECOVER INDIRECT COSTS INCURRED IN ADMINISTERING FEDERAL GRANTS.

INTERNAL CONTROL

We have examined the financial schedules of the Montana Arts Council for the fiscal years ending June 30, 1984, and 1985. We issued our opinion dated January 20, 1986, on these schedules. As part of our examination, we made a study and evaluation of the system of control of the Montana Arts Council. Our study evaluated the system as required by generally accepted auditing standards and Standards for Audit of Governmental Organizations, Programs, Activities, and Functions. We classified the controls in the following categories: grants/revenue; expenditures; and payroll. Our study included the control categories listed above. Through our study, we determined the nature, timing, and extent

of our auditing procedures. We applied alternative audit tests to payroll because the audit could be performed more efficiently by expanding substantive audit work. We did not evaluate the control system to the extent necessary to give an opinion on either individual segments or the system as a whole.

The management of the Montana Arts Council is responsible for establishing and maintaining a system of accounting control. In fulfilling this responsibility, estimates and judgments by management are required to assess the expected benefits and related costs of control procedures. The objectives of a system are to provide management with reasonable assurance that: 1) assets are safeguarded against loss from unauthorized use or disposition; 2) transactions are executed in accordance with management's authorization; and 3) transactions are recorded properly to permit the preparation of financial schedules in accordance with state accounting policies. Inherent limitations in any system of controls may allow errors or irregularities to remain undetected. The current evaluation of the system should not be used to project to future periods since the procedures may become inadequate or compliance with them may deteriorate.

The limited purpose of our study described in the first paragraph would not necessarily disclose all material weaknesses in the system. Accordingly, we do not express an opinion on the system of controls used by the Montana Arts Council. However, our study and evaluation disclosed conditions indicating control weaknesses exist. These conditions relate to cash receipts and deposits and are discussed below.

The preceding three paragraphs are intended solely for the use of management and the Legislature and should not be used for any other purpose. This restriction as to use is not intended to limit the distribution of this document which, upon presentation to the Legislative Audit Committee, is a matter of public record.

Cash Collections

The Montana Arts Council receives funds from various sources. Sources include community match money for the Artist in the Schools program, federal grants, and the Governor's Arts Award Banquet. These funds are sent directly to the council and were approximately $350,000 each fiscal year of the audit period.

State law and council policy require checks be restrictively endorsed upon receipt. Checks received by the council are not restrictively endorsed when mail is opened but are endorsed at a later time.

State law requires agencies deposit receipts when coin and currency exceeds $100 or total collections exceed $500. Weekly deposits are required regardless of the amount being held for deposit. One deposit accumulated to $10,000 before a deposit was made. In another deposit some checks were two months old.

If deposits are not made on a frequent basis, the potential for money to be lost or stolen increases. This potential is also increased when checks are not restrictively endorsed immediately upon receipt. Agency officials stated no specific reasons for not depositing receipts more frequently.

RECOMMENDATION #5

WE RECOMMEND THE MONTANA ARTS COUNCIL:

A. RESTRICTIVELY ENDORSE CHECKS IMMEDIATELY UPON RECEIPT, AND

B. MAKE DEPOSITS IN ACCORDANCE WITH STATE LAW.

ACCOUNTING ISSUES

The Montana Operations Manual and management memos issued by the Department of Administration, Accounting Division, provide agencies with guidelines and certain requirements for recording activity on the Statewide Budgeting and Accounting System (SBAS). Individual agency deviations or omissions can result in management or accounting which is not in compliance with state policy. During our audit of the Montana Arts Council, we noted deficiencies

regarding the council's compliance with those policies and guidelines.

Expenditure Recognition

The council does not recognize expenditures in compliance with state policy. State accounting policy requires that a valid obligation must exist before an expenditure can be accrued. Specifically, payroll costs are to be accrued in the fiscal year in which earned and termination pay is to be accounted for as an expenditure in the fiscal year in which the employee terminates. The following four subsections describe errors made by the council in recognizing expenditures on SBAS. The errors had the following effect (overstatement) on expenditures:

	1983-84	1984-85
General Fund	$8,713	$576
Special Revenue Fund	242	576

Termination Pay

The Montana Arts Council moved its office from Missoula to Helena in May 1984. At that time, the council received an appropriation of $14,562 from the legislature for termination pay, moving expenses, and telephone installation expenditures incurred during the move. At the end of fiscal year 1983-84, the council accrued $8,713 for termination pay for an employee who had not yet terminated.

As of June 30, 1985, the accrual was still recorded on the agency's records. The employee whose termination pay was accrued terminated employment at the council in January, 1986. The employee did not terminate at the time of the move in order to obtain a more beneficial retirement status. In addition to being an invalid accrual per accounting policy, the charge against the council's appropriation for moving expenses does not comply with the legislative intent of the appropriation. The employee's

termination did not occur because of the office's relocation, but is due to other factors.

Personal Services

The council accrued expenditures of $6,394 at fiscal year-end 1983-84 in anticipation of adding and training new employees to replace the two employees who planned to terminate because of the council's move to Helena. The council's employees had not terminated and the new employees were not employed at the time of the accrual.

In fiscal year 1984-85, the council accrued $1,152 for a retroactive pay increase for a state employee. In order for the employee to receive the pay increase, a reclassification process with the Department of Administration's Personnel Division must be completed. This reclassification process had not begun at the end of fiscal year 1984-85; therefore, no accrual was justified.

Grants

At fiscal year-end 1983-84, the council accrued the appropriation balance of the Basic State Grant appropriation, although no valid obligation existed for the accrual. The amount accrued was $2,537. Council personnel indicated the appropriation balance was accrued to preserve spending authority.

Abatements

In fiscal year 1983-84, the council reversed expenditures of $8,689 originally recorded for payment of annual dues of the Western States Foundation. The dues related specifically to fiscal year 1983-84; therefore the expenditures as originally recorded were correct.

The council reversed the expenditure in order to charge it against a fiscal year 1982-83 expenditure accrual. This accrual had been made incorrectly at the end of fiscal year 1982-83 as no valid obligation had existed at the time.

RECOMMENDATION #6

WE RECOMMEND THE MONTANA ARTS COUNCIL:

A. REVERSE ACCRUAL TRANSACTIONS NOT BASED ON VALID OBLIGATIONS.

B. COMPLY WITH STATE POLICY REGARDING EXPENDITURE RECOGNITION AND ACCRUE ONLY WHEN VALID OBLIGATIONS EXIST.

Fixed Asset Records

The Montana Arts Council does not maintain a consolidated record of all fixed assets owned. State accounting policy requires that the council maintain a record of fixed assets on the Statewide Accounting and Budgeting System (SBAS). The council has recorded only one asset on the Property Accountability Management System (PAMS), a subsidiary ledger of SBAS. Another listing the council maintains on its microcomputer is not complete. Without such records, the council's accountability for its fixed assets is seriously impaired. Since the council continually loans items of equipment for use in sponsored projects, accountability is especially important.

We could not audit the council's fixed asset records. Our prior audit recommended that the Montana Arts Council implement PAMS to manage and account for fixed assets owned. The council concurred with our recommendation but did not implement PAMS during our audit period. We noted the council recorded fixed assets on PAMS in January 1986.

RECOMMENDATION #7

WE RECOMMEND THE MONTANA ARTS COUNCIL COMPLY WITH STATE PROPERTY ACCOUNTING POLICY BY IMPLEMENTING THE PROPERTY ACCOUNTABILITY MANAGEMENT SYSTEM.

STAFF TRAINING

We noted accounting errors during our audit that were made as a result of the council's staff lack of training in SBAS procedures. Some examples of deficiencies noted are as follows:

-- Moving expenses and personal services were coded as grant expenditures.

-- Several documents were assigned the same number in the same fiscal year. The Montana Operations Manual (2-0925) suggests agencies maintain document numbering logs for each type of form to assure each document is identified with a sequential, nonrepetitive number.

The following three sections also describe errors that occurred as a result of inadequate training of the council's staff. Adequate training is necessary to ensure accounting transactions are processed in accordance with state policy. The state conducts training on SBAS procedures several times a year. The council should obtain the necessary SBAS training for its accounting staff.

Revenue Recognition

The Montana Arts Council did not recognize revenue in accordance with state accounting policy. The council receives its funds from the federal government on a letter of credit. The funds are received in advance of anticipated expenditures. State accounting policy requires that revenue be recorded when the expenditure has been made. Conversely, if the expenditure is made before the receipts are received, revenue should be accrued for the amount of the expenditure.

If revenue is recorded correctly, the fund balance of the federal grant accounting entities should be zero at fiscal year-end. Fund balance for the federal accounting entities at fiscal year-end 1983-84 was a negative $200. Fund balance at fiscal year-end 1984-85 was a negative $9,606. The council should have accrued revenue for the amount of the expenditures made.

We noted this problem in our previous two audits of the council. The council concurred with our recommendation but did not implement it.

Cash Restatement

The Department of Administration has established special receivable and payable accounts to be used for receipts and disbursements during the fiscal year-end adjustment period. The special accounts are used in order for the financial statements to accurately reflect June 30 cash balances. These accounts are automatically generated in place of the cash account during the adjustment period.

According to Management Memo 2-85-2, transactions that occur within an accounting entity of the council are proper adjustments to the cash account during the adjustment period and must be specially coded.

Our prior audit recommended that the council correctly code intra-entity transactions during the adjustment period. The council attempted to implement this recommendation, but several adjustments to cash were incorrectly coded as receivables and/or payables. These errors did not affect the financial schedules presented in this report.

Documentation

The council did not comply with state policy requiring SBAS documents in the agency's file be properly and adequately supported. In order to adequately explain accounting transactions, the council's accountant had to recreate supporting documentation during our audit. This took a substantial amount of time.

The council's accountant initiates most transactions. If the accountant should terminate employment at the council, new personnel would not be able to adequately explain accounting transactions because documents are not self-explanatory.

The council's accountant did not know about the requirements for supporting documentation. Supporting documentation should be

attached to the SBAS document at the time the transaction is initiated. Complete explanations of the transactions should be placed on the face of the document or attached to it.

RECOMMENDATION #8

WE RECOMMEND THE MONTANA ARTS COUNCIL:

A. OBTAIN NECESSARY SBAS TRAINING FOR ITS ACCOUNTING STAFF.

B. RECORD FEDERAL GRANT REVENUE IN ACCORDANCE WITH STATE ACCOUNTING POLICY.

C. COMPLY WITH STATE POLICY BY FOLLOWING THE PROCEDURES OUTLINED IN THE YEAR-END CASH CUTOFF MEMO.

D. COMPLY WITH STATE POLICY BY ADEQUATELY SUPPORTING ALL SBAS DOCUMENTS.

AUDITOR'S OPINION LETTER
AND AGENCY FINANCIAL SCHEDULES

SUMMARY OF AUDIT OPINION

The auditor's opinion issued in this report is intended to convey to the reader of the financial schedules the degree of reliance which can be placed on the amounts presented. The reader may rely on the fairness of the amounts presented except for the specific item discussed in paragraph 3 of the auditor's opinion.

STATE OF MONTANA

Office of the Legislative Auditor

STATE CAPITOL
HELENA, MONTANA 59620
406/444-3122

SCOTT A. SEACAT
LEGISLATIVE AUDITOR

DEPUTY LEGISLATIVE AUDITORS:
JAMES GILLETT
FINANCIAL-COMPLIANCE AUDITS
JIM PELLEGRINI
PERFORMANCE AUDITS

LEGAL COUNSEL:
JOHN W. NORTHEY

The Legislative Audit Committee
of the Montana State Legislature:

We have examined the financial schedules of the various funds of the Montana Arts Council for each of the fiscal years ending June 30, 1984, and 1985 as shown on pages 20 through 26. Our examination was made in accordance with generally accepted auditing standards and Standards for Audit of Governmental Organizations, Programs, Activities, and Functions and, accordingly, included such tests of the accounting records and such other auditing procedures as we considered necessary in the circumstances.

As described in Note 1 to the financial schedules, the department's financial schedules are prepared in accordance with state accounting policy. Accordingly, the accompanying financial schedules are not intended to present financial position and results of operations in conformity with generally accepted accounting principles.

The Special Revenue Fund balance at June 30, 1985, as presented on the Schedule of Changes in Fund Balance is understated by $10,183. This misstatement was caused by the council recording improper accruals and not recognizing revenue when earned.

In our opinion, except for the effect of the matter discussed in paragraph three, the Schedule of Changes in Fund Balance for the Special Revenue Fund presents fairly the results of operations and the changes in fund balance of such funds of the Montana Arts Council for the two fiscal years ended June 30, 1985, in

conformity with the basis of accounting described in Note 1 applied on a consistent basis.

In our opinion, the Schedule of Changes in Fund Balance for the General Fund for the two fiscal years ended June 30, 1985 as presented on page 20 and the financial schedules presented on pages 21 through 26, present fairly the results of operations and changes in fund balance of such funds of the Montana Arts Council for the two fiscal years ended June 30, 1985, in conformity with the basis of accounting described in Note 1 applied on a consistent basis.

Our examination was made for the purpose of forming an opinion on the financial schedules referred to in paragraph one. The accompanying Schedule of Grants is presented for additional analysis and disclosure purposes. The schedule has been subjected to the tests and other auditing procedures applied in the examination of the financial schedules above and, in our opinion, except for the effect, if any, of the matter discussed in paragraph three is fairly stated in all material respects in relation to the financial schedules referred to in paragraph one.

Respectfully submitted,

James Gillett

James Gillett, CPA
Deputy Legislative Auditor

January 20, 1986

MONTANA ARTS COUNCIL
SCHEDULE OF CHANGES IN FUND BALANCE
FOR THE TWO FISCAL YEARS ENDED JUNE 30, 1985

	General Fund	Special Revenue Fund
FUND BALANCE, July 1, 1983	$ -0-	$ 3,032
ADDITIONS:		
Fiscal Year 1983-84		
Budgeted Revenue		707,370
Nonbudgeted Revenue		(194)[A]
Total Revenue		707,176
Prior Year Revenue Adjustment		7,663
Support from State of Montana	130,881	
Direct Entries to Fund Balance		49,404
Fiscal Year 1984-85		
Budgeted Revenue		935,853
Prior Year Revenue		(11,250)
Prior Year Revenue Adjustment		3,986
Support from State of Montana	119,889	
Direct Entries to Fund Balance		176,808
Total Additions	250,770	1,869,640
REDUCTIONS:		
Fiscal Year 1983-84		
Budgeted Expenditures	130,881	624,773
Cash Transfers Out		137,170
Fiscal Year 1984-85		
Budgeted Expenditures	119,739	1,034,004
Prior Year Expenditure Adjustments	150	147
Cash Transfers Out		100,188
Total Reductions	250,770	1,896,282
FUND BALANCE, June 30, 1985	$ -0-	$ (23,610)

[A]This is not revenue but a decrease in inventory.

This schedule is prepared from the Statewide Budgeting and Accounting System. Additional information is provided in the notes to the financial schedules on pages 24 through 26.

MONTANA ARTS COUNCIL
SCHEDULE OF REVENUE
ESTIMATE AND ACTUAL
FOR THE TWO FISCAL YEARS ENDED JUNE 30, 1985

FISCAL YEAR 1984-85

	Investment Earnings	Grants, Gifts, Bequests and Donations	Federal Assistance	Total
SPECIAL REVENUE FUND				
Estimated Revenue	$1,095,765	$52,500	$387,300	$1,535,565
Actual Revenue	504,818	48,880	382,155	935,853
Collections Over (Under) Estimate	$ (590,947)	$(3,620)	$ (5,145)	$ (599,712

FISCAL YEAR 1983-84

	Investment Earnings	Grants, Gifts, Bequests and Donations	Federal Assistance	Income Collections and Transfers	Total
SPECIAL REVENUE FUND					
Estimated Revenue	$ 868,479	$72,500	$343,154	$ -0-	$1,284,133
Actual Revenue	309,346	67,625	330,399	(194)[A]	707,176
Collections Over (Under) Estimate	$(559,133)	$(4,875)	$(12,755)	$ (194)	$(576,957

[A]This is not revenue, but the decrease in inventory.

This schedule is prepared from the Statewide Budgeting and Accounting System. Additional information is provided in the notes to the financial schedules on pages 24 through 26.

MONTANA ARTS COUNCIL
SCHEDULE OF PROGRAM EXPENDITURES BY FUND
BUDGET AND ACTUAL
FOR THE TWO FISCAL YEARS ENDED JUNE 30, 1985

	Promotion of the Arts	
	Fiscal Year 1984-85	Fiscal Year 1983-84
GENERAL FUND		
Budget	$ 119,739	$ 131,031
Actual		
Personal Services	46,334	65,565
Operating Expenses	49,033	42,021
Equipment	917	1,377
Grants	23,455	21,918
Total Actual	119,739	130,881
Unspent Budget Authority	$ -0-	$ 150
SPECIAL REVENUE FUND		
Budget	$1,103,629	$1,274,133
Actual		
Personal Services	46,335	53,000
Operating Expenses	235,324	214,938
Equipment	978	1,376
Grants	751,367	355,459
Total Actual	1,034,004	624,773
Unspent Budget Authority	$ 69,625	$ 649,360
PROGRAM TOTAL		
Budget	$1,223,368	$1,405,164
Actual		
Personal Services	92,669	118,565
Operating Expenses	284,357	256,959
Equipment	1,895	2,753
Grants	774,822	377,377
Total Actual	1,153,743	755,654
Unspent Budget Authority	$ 69,625	$ 649,510

This schedule is prepared from the Statewide Budgeting and Accounting System. Additional information is provided in the notes to the financial schedules on pages 24 through 26.

MONTANA ARTS COUNCIL
SCHEDULE OF PROGRAM EXPENDITURES BY OBJECT
FOR THE TWO FISCAL YEARS ENDED JUNE 30, 1985

	Promotion of the Arts	
	Fiscal Year 1984-85	Fiscal Year 1983-84
PERSONAL SERVICES		
Salaries	$ 77,592	$ 88,945
Hourly Wages		11,005
Employee Benefits	15,077	18,614
Total Personal Services	92,669	118,564
OPERATING EXPENSES		
Contracted Services	191,638	176,846
Supplies and Materials	23,721	23,458
Communication	17,633	14,280
Travel	35,694	27,956
Rent	12,741	10,260
Repair and Maintenance	830	1,101
Other Expenditures	2,100	3,059
Total Operating Expenses	284,357	256,960
EQUIPMENT		
Equipment	1,895	2,753
Total Equipment	1,895	2,753
GRANTS		
From State Sources	574,296	208,638
From Federal Sources	200,526	168,739
Total Grants	774,822	377,377
TOTAL PROGRAM EXPENDITURES	$1,153,743	$755,654

This schedule is prepared from the Statewide Budgeting and Accounting System. Additional information is provided in the notes to the financial schedules on pages 24 through 26.

MONTANA ARTS COUNCIL

NOTES TO FINANCIAL SCHEDULES

FOR THE TWO FISCAL YEARS ENDED JUNE 30, 1985

1. SUMMARY OF SIGNIFICANT ACCOUNTING POLICIES

A. Basis of Accounting

The state of Montana utilizes the modified accrual basis of accounting which is described in the Montana Operations Manual, except for grant receipts which are accounted for on the cash basis of accounting.

Under the modified accrual basis of accounting, a valid obligation exists when the related liability is incurred except for the following items which are also considered valid obligations under state accounting policy.

--If the appropriation provided funds to complete a given project, the entire amount of a contract may be accrued even though the services are rendered in fiscal years subsequent to the fiscal year in which the expenditure is accrued.

--The anticipated cost of equipment is expensed in the fiscal year in which budgeted.

--Goods ordered, but not received as of the fiscal year-end, may be accrued if the purchase order was issued in the fiscal year in which the anticipated expenditure is to be accrued.

B. Basis of Presentation

The financial schedules were prepared from the Statewide Budgeting and Accounting System (SBAS) without adjustments, except for the Schedule of Federal Grant Receipts which was prepared from automated records maintained by Montana Arts Council personnel. Accounts are organized on the basis of funds according to state law. The following types are used by the council:

General - accounts for all financial resources except those required to be accounted for in another fund.

Special Revenue - accounts for the proceeds of specific revenue sources that are legally restricted to expenditures for specified purposes. Legislative appropriations are required to be spent from this fund type. This activity includes Cultural and Aesthetic grants (coal tax money), Basic State Grants and Artists in Schools residences.

2. ANNUAL AND SICK LEAVE

Employees at the department accumulate both annual and sick leave. Employees are paid for 100 percent of unused annual and 25 percent of unused sick leave credits upon termination. Accumulated unpaid liabilities for annual and sick leave are not reflected in the financial schedules of the Montana Arts Council. Expenditures for termination pay currently are absorbed in the annual operational costs of the department. At June 30, 1985, the council had an approximate liability of $11,772 for annual leave and $8,165 for sick leave.

3. PENSION PLAN

State employees of the council are covered by the Montana Public Employees' Retirement System (PERS). The department's contribution to this plan was $6,418 in fiscal year 1983-84 and $4,917 in fiscal year 1984-85.

4. GENERAL FUND BALANCE

The General Fund is a Statewide Fund. Agencies do not have a separate General Fund since their only authority is to pay obligations from the Statewide General Fund as long as they stay within their appropriation limits. Thus, on an agency schedule, the beginning and ending fund balance will always be zero for the General Fund.

5. DIRECT ENTRIES TO FUND BALANCE

Special Revenue Fund - these entries show the transfer of the Cultural and Aesthetic Program funding from the Historical Society to the council and restatement of cash balances in the Cultural and Aesthetic accounting entity.

6. BUDGET INFORMATION

The council utilizes a fixed basis of budgeting. Appropriations of specific dollar amounts are set for each fiscal year in a biennium by the Legislature. Appropriations control the financial operations of the council each fiscal year. At fiscal year-end, appropriations (with the exception of continuing appropriations and biennial appropriations) revert to the fund of original appropriation. The reverted appropriation balance may be used in the subsequent year as authorization for valid prior year obligations.

Budget amendments represent the authorization to spend funds not available for consideration by the Legislature but available from sources other than General Fund. Budget amendments are approved by the Governor's Office of Budget and Program Planning.

7. INVESTMENT EARNINGS

The investment earnings as classified on the Schedule of Revenue and Transfers In - Estimate and Actual are earnings from the Coal Tax Park Acquisition investments. These investments are recorded on the Department of Revenue's accounts. The earnings go to the Department of Revenue and are then transferred to the Montana Arts Council.

MONTANA ARTS COUNCIL
SCHEDULE OF FEDERAL GRANT RECEIPTS
FOR THE TWO FISCAL YEARS ENDED JUNE 30,1985

Grant Number	Grant Name	Fiscal Year Ended June 30, 1984	Fiscal Year Ended June 30, 1985
	Basic State Grant		
32-6141-00028	FY 84 FSP	$286,100	
42-6141-0041	FY 85 FSP	13,900	$323,800
	Total FSP	300,000	323,800
	Other		
32-5150-00027	Artists in Schools	48,285	
42-5151-0028	Artists in Schools		49,600
12-5530-062	Folklife		8,300
Total federal grants		$348,285	$381,700

Note: The schedule above has been prepared on a cash basis. Depending on the timing of transactions, cash receipts may not always be equal to revenue.

AGENCY REPLIES

MONTANA ARTS COUNCIL

TED SCHWINDEN, GOVERNOR
35 SOUTH LAST CHANCE GULCH
STATE OF MONTANA
(406) 444-6430
HELENA, MONTANA 59620

April 7, 1986

RECEIVED
APR 7 1986
MONTANA LEGISLATIVE AUDITOR

Gerard Poore
Office of the Legislative Auditor
State Capitol
Helena, MT 59620

Dear Gerard:

Enclosed we are returning the two copies of the narrative and finanacial schedule segments of your final report on the audit of the Montana Arts Council. Also enclosed find an original of our response to your recommendations. If you have any further requests and/or questions, please feel free to contact myself or Carleen Lassise.

I would like to take this opportunity again to thank your staff for their general efficiency and effectiveness and for making this a pleasant--as pleasant as an audit can be--and helpful experience. We always look forward to your suggestions for maximizing our accountability.

Sincerely,

DEN by cl

David E. Nelson

Enclosures

publications & graphics

Recommendation #1
The Council and the Office of Budget and Program Planning convert contract employee positions to state FTE.

Agency response: We concur and have submitted the request that this happen to the Office of Budget and Program Planning in the first step of the Executive Planning Process.

Recommendation #2
The Council:

A. Ensure federal financial reports are prepared in accordance with the instructions included in "Circular A-102, Attachment H".

Agency response: We concur. Sufficient back-up is retained to document the amounts presented on the federal reports and tie them to SBAS, which includes listing the SBAS Responsibility Center numbers directly on the reports. Due to AIS program staff turnover, the computerization of the federal report process, and the shift in responsibility for reports, this recommendation from the prior report has not been fully implemented, but will be. The incorrect amounts noted in the report are non-cash matching items which did not show up on SBAS.

B. Submit reports in a timely manner or obtain written documentation from the NEA approving an extension of the reporting deadline.

Agency response: We concur. We have been assured by the Endowment that our reports are timely, but to meet this audit recommendation, routinely submitted extensions would be preferable to changing reporting deadline dates.

C. Establish procedures to ensure subgrantees issue required reports to the council in a timely manner.

Agency response: We concur. Most of the difficulty we experience with late subgrantee reports are from the University system. The auditor's suggestion that grants to the University be on a reimbursement basis is being considered, along with other procedures to ensure reports are received in a timely manner.

Recommendation #3
The Council:

A. Ensure subgrantees commit the granted funds within the grant period before disbursing the final payment.

Agency response: We concur, but see agency response to #3.B. Each of the three grants identified in the report is addressed separately. (1) The $30,000 grant to Fort Owen: this group was in communication with us throughout the grant period. The grant funds were "committed" during the grant period with the group working very hard to accomplish the original intent of the proposal. It took three months after the end of the grant period for them to find a vendor for the very specific bricks needed for historical accuracy. (2) The $2,700 grant to the Conrad Library: though

nothing in the original proposal indicated at what level the project had been completed, the windows were restored early on so as to make the building energy efficient and safeguard it from further deterioration. The Library Foundation paid for the work at the time it was done and was reimbursed by the grant as received. (3) The $50 of travel expenditures of the Yellowtail Documentary: This is an on-going project continuing to receive funding in this biennium as well. The travel expenditures made after the grant period were an oversight on the part of the subgrantee and could be easily corrected with the same amount of expenditures in the proper period.

B. Request reimbursement from the grantees for the above unallowable grant expenditures.

Agency response: We will make a full report as to the circumstances of each of these grants to the appropriate Legislative sub-committee and request their guidance on dealing with these grants. We will also notify the subgrantee in each case as to this recommendation. As these are legislative grants, we do not see ourselves as having the authority to request reimbursement from the grantees and will request clarification as to our authority concerning both parts of this recommendation.

Recommendation #4
The Council negotiate an agreement with the federal government to recover indirect costs incurred in administering federal grants.

Agency response: We concur. We are attempting to comply with this recommendation. We have had difficulty receiving concrete guidance and have recently found a knowledgeable source within state government to assist. In the meantime, we remain open to being billed directly for the federal share of Statewide Costs Allocation Plan charges to be repaid from our federal sources.

Recommendation #5
The Council:

A. Restrictively endorse checks immediately upon receipt.

Agency response: We concur. New staff have been reinstructed as to state law and council policy and compliance will be monitored.

B. Make deposits in accordance with state law.

Agency response: We concur. New staff have been reinstructed as to state law and council policy and compliance will be monitored.

Recommendation #6
The Council:

A. Reverse accrual transactions not based on valid obligations.

Agency response: We do not concur. The transactions noted were primarily involved with the agency's relocation from Missoula to Helena and were legitimate. The timing was a difficult issue and had to be planned to fit in the agency's on-going workload. It was also a difficult transition for staff and the agency felt itself to be responsible to make the transition as smooth and humane as possible for everyone involved. Not terminating people by fiscal year end of 1984 was one of those concessions that the agency believed was reasonable to make. In addition, reversing the accruals after they have been paid and absorbing the cost out of current appropriations (the amounts in question are 15.4% of our current general fund administrative appropriation) would have a devastating effect on the agency.

B. Comply with state policy regarding expenditure recognition and accrue only when valid obligations exist.

Agency response: We concur and will comply.

Recommendation #7
The Council comply with state property accounting policy by implementing the property accountability management system.

Agency response: We concur and have implemented.

Recommendation #8
The Council:

A. Obtain necessary SBAS training for its accounting staff.

Agency response: We concur and will comply.

B. Record federal grant revenue in accordance with state accounting policy.

Agency response: The Department of Administration Accounting Division provided the information to implement this recommendation at both fiscal year ends and it was implemented to the best of our knowledge. The fund balance at both fiscal year ends was zero. The balances indicated in the report are following the post closing adjustments. We will work more closely with the Accounting Division to assure that the proper adjustments are made.

C. Comply with state policy by following the procedures outlined in the year-end cash cutoff memo.

Agency response: We concur and will comply.

D. Comply with state policy by adequately supporting all SBAS documents.

Agency response: We concur and will comply.

OFFICE OF THE GOVERNOR
BUDGET AND PROGRAM PLANNING

TED SCHWINDEN, GOVERNOR

STATE CAPITOL

STATE OF MONTANA

(406) 444 3616

HELENA, MONTANA 59620

March 28, 1986

RECEIVED
APR 4 1986
MONTANA LEGISLATIVE AUDITOR

Scott Seacat, Legislative Auditor
Office of the Legislative Auditor
State Capitol
Helena, Montana 59620

Dear Mr. Seacat:

Gerard Poore of your staff has requested my response to an audit recommendation made for the Montana Arts Council. The recommendation asks this office to establish 7 FTE positions for people currently working as independent contractors.

While I agree with the argument that these individuals are not "independent contractors", I cannot establish the FTE to accomplish the recommendation. I base this decision on the action of the past legislative session which specifically addressed and denied the request to establish FTE's for these individuals, (please refer to attachment A).

The Governor's budget for the current biennium asked for these FTE designations. I anticipate that our recommendation to the next legislative session will again include this recommendation.

I suggest that you advise the Legislative Fiscal Analyst of your recommendation. This will help insure that both the Governor's budget and the LFA analysis of that budget, include an explanation of why the FTE designation is important.

Sincerely,

David L. Hunter

David Hunter, Director
Office of Budget and Program Planning

attachments

LAOArtsC.mis

publications & graphics

MONTANA ARTS COUNCIL

(235) Pam Joehler of the Legislative Fiscal Analyst's Office handed out a breakdown of the difference between the OBPP budget request and the LFA current level (Exhibits 2 and 3). She also outlined the affect of converting contracts to state FTE (Exhibit 4). Chairman Waldron noted there would be no net increase in general fund to do the switch. Also, he said the Oral History Project and the Folklife Project would be considered modifieds if this committee chooses to fund them with general fund money. The OBPP has people in their figures twice; once in contracted services under Operating Expenses and once in FTE under Personal Services.

In the Grants Program, general fund was taken from the community grants to free up about $7,000 in federal funds for grants.

Sen. Aklestad feared that, if we convert the contracted positions to FTE and federal funds drop off, we will have FTE with no money to administer. If the federal funds are withdrawn, a decision will have to be made whether to supplant the federal funds or withdraw part of the program. Currently, the FTE are funded with federal funds. This issue was discussed in depth.

ADMINISTRATION PROGRAM: (590)

Sen. BENGTSON moved to accept the LFA current level for Personal Services which does not include the switch from contracted services to state FTE.

Chairman Waldron requested a roll call vote be taken. Reps. MENAHAN and WALDRON opposed the motion. All other members approved the motion. The motion PASSED.

Sen. BENGTSON moved to accept the LFA current level for Operating Expenses but to reverse the years for the audit costs of $8,400 from FY 87 to FY 86.

The motion PASSED unanimously.